Summary of FY2014 FHA Annual Report to Congress on the Financial Health of the Mutual Mortgage Insurance Fund

November 17, 2014

Summary

1. The **MMI Fund is now positive, having improved by ~$21 billion** over past two years. It now stands at $4.8 billion in economic value with a capital ratio of 0.41%

2. Improvement in the Fund is a result of aggressive policy actions that have led to better portfolio performance. For example, since last year
   a. **Delinquency rates have improved by 14%**
   b. **Recovery rates have improved by 16%**
   c. ~$40 billion in cash and reserves available

3. With the MMI Fund on a strong and positive trajectory, FHA is focused on addressing the uneven housing recovery through our Blueprint for Access

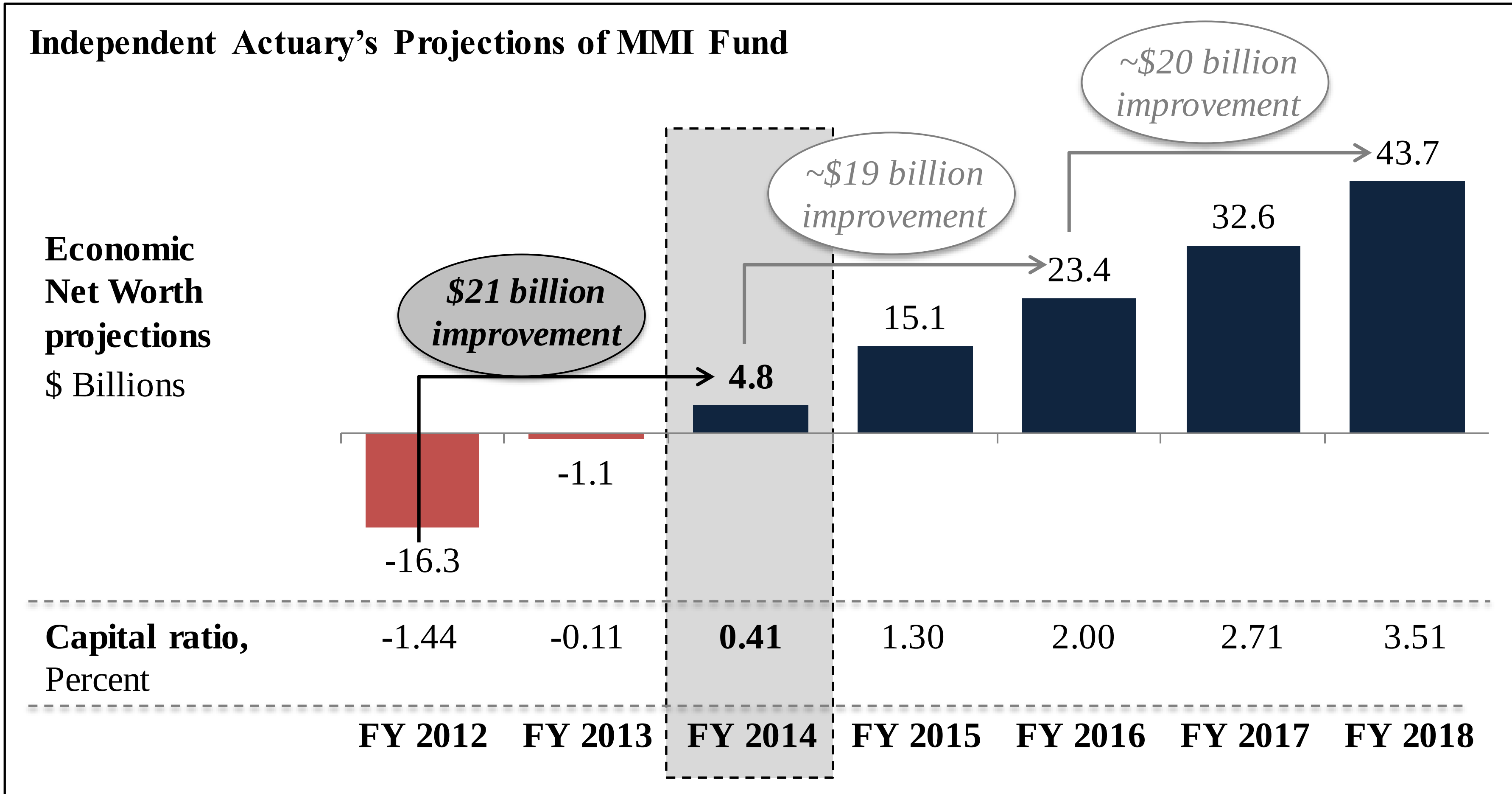
4. The legacy reverse mortgage portfolio remains volatile but FHA continues to focus on making long-term improvements to the program

MMI Fund: Back in the Black

- MMI Fund is **positive** and on a **strong trajectory**
- Since last year, the Fund improved by $6 billion and $21 billion over the past two years
- Robust policy actions led to this result
- With Fund on the right track, FHA is sharpening its focus on facilitating access for creditworthy families

Source: FY2014 Actuarial Report, FY2014 FHA Annual Report

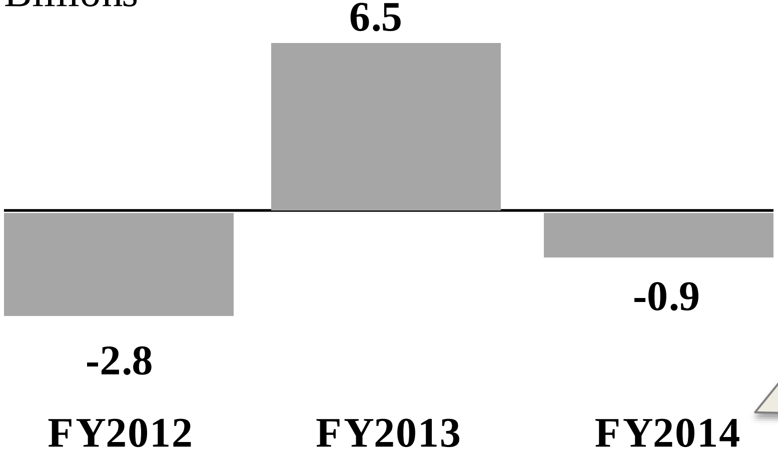
MMI Fund value is now positive and continues on a strong trajectory



HECM's legacy portfolio remains sensitive to long-term economic forecasts

Economic Value of HECM – Independent Actuary's Estimates

$ Billions



Drop in FY2014 almost entirely driven by expectations for higher long-term interest rates

Change in value for FY2013 driven by $4 billion transfer of capital from Forwards and $1.7 billion mandatory appropriation

Key drivers

- Volatility in long-term house prices
- Volatility in long-term interest rates
- Historical book
- Modeling methods

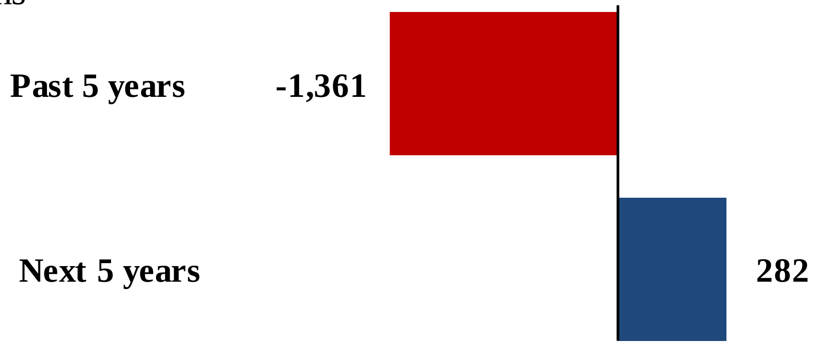
FHA continues to take further action to stabilize the HECM program

Examples of actions taken to improve HECM program

1. Adjustment to Principal Limit Factors
2. Limited Maximum Draws in the first year
3. Established non-borrowing spouse deferral period
4. Reiterated prohibition on misleading or deceptive advertising/marketing
5. Implement revised HECM financial assessment and property charge set aside guide

Average Annual Economic Value – Independent Actuary's Estimates

$ Billions



Additional actions in progress

1. Address policies regarding treatment of ineligible non-borrowing spouse
2. Issue proposed rule formalizing all regulatory changes made under the HECM Stabilization Act authority
3. Draft and publish HECM Handbook to clarify rules and simplify communication of guidelines

Source: FY2014 Actuarial Report, FY2014 FHA Annual Report

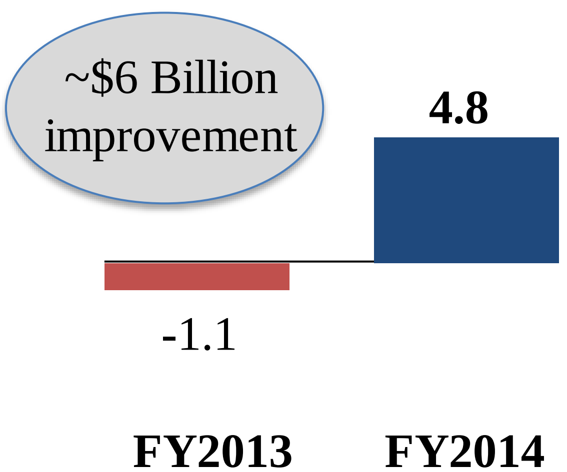
Despite HECM challenges, independent assessment shows significant improvement for overall MMI Fund

Official results of the Independent Actuary

FY2013 vs. FY2014 assessment

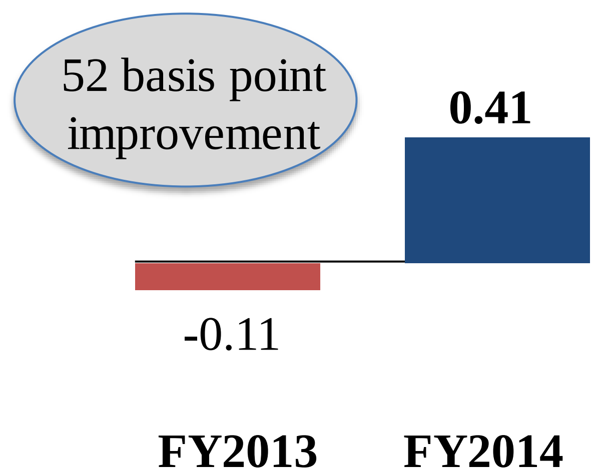
Economic Net Worth

$ Billions



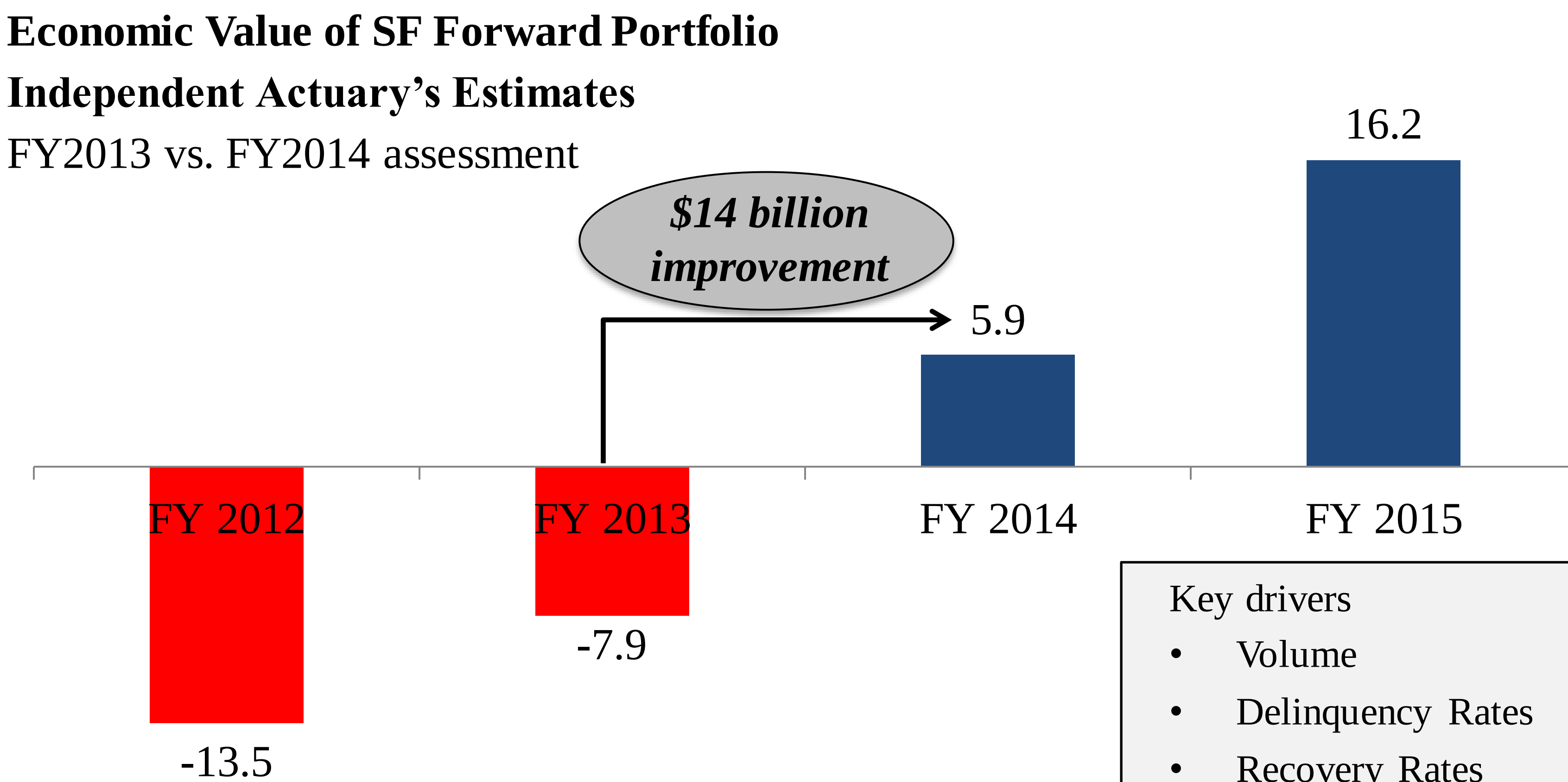
Capital ratio

Percent



Source: FY2014 Actuarial Report, FY2014 FHA Annual Report

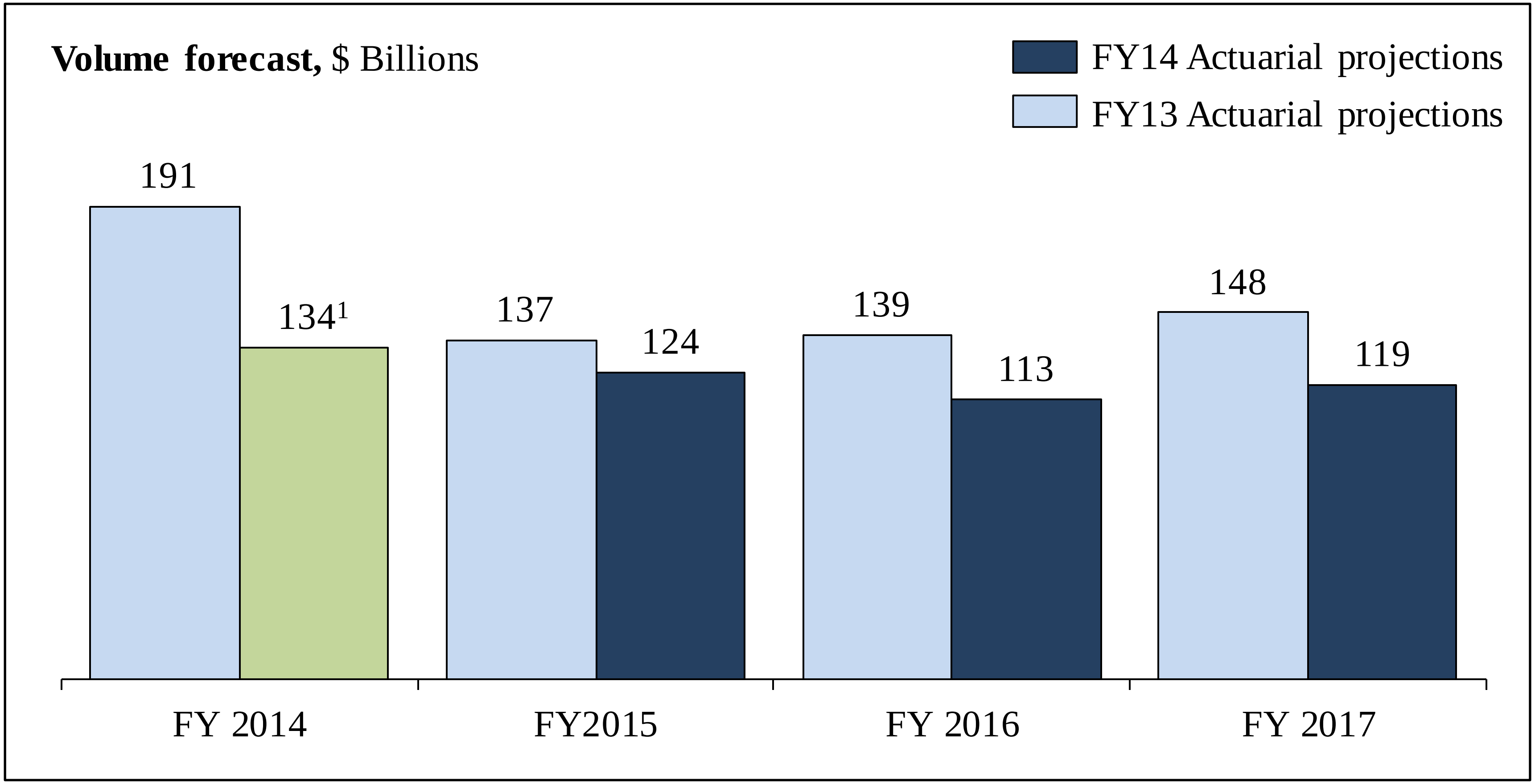
SF Forward portfolio is carrying the improvement, having improved ~$14 billion vs last year



Key drivers

- Volume
- Delinquency Rates
- Recovery Rates
- Premiums

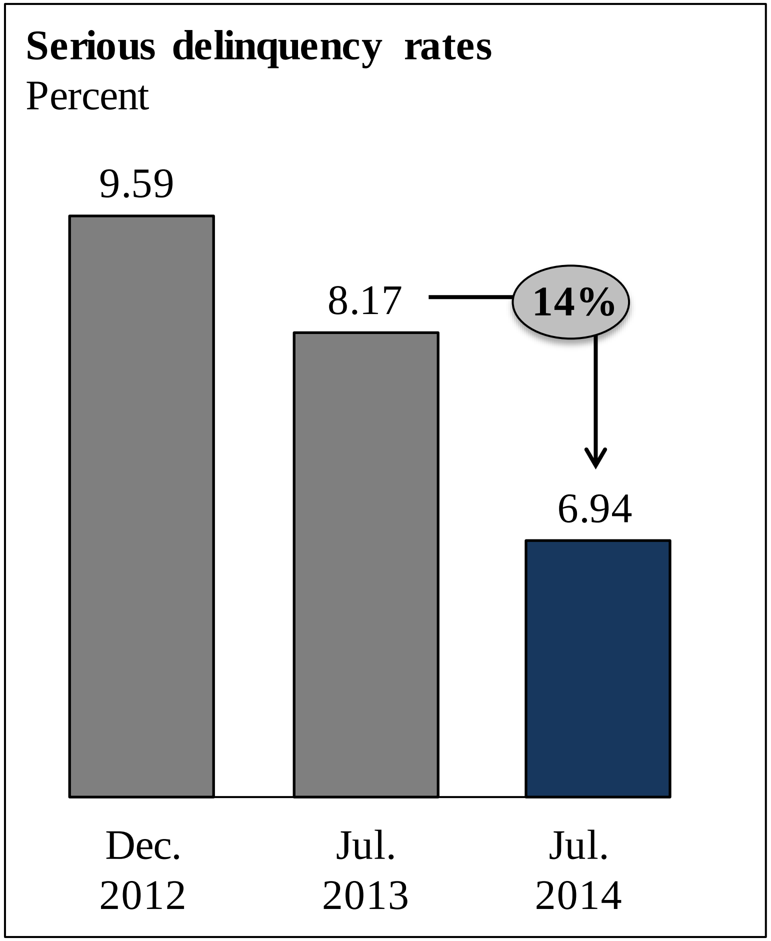
Independent Actuary's volume forecasts are lower than last year's projections

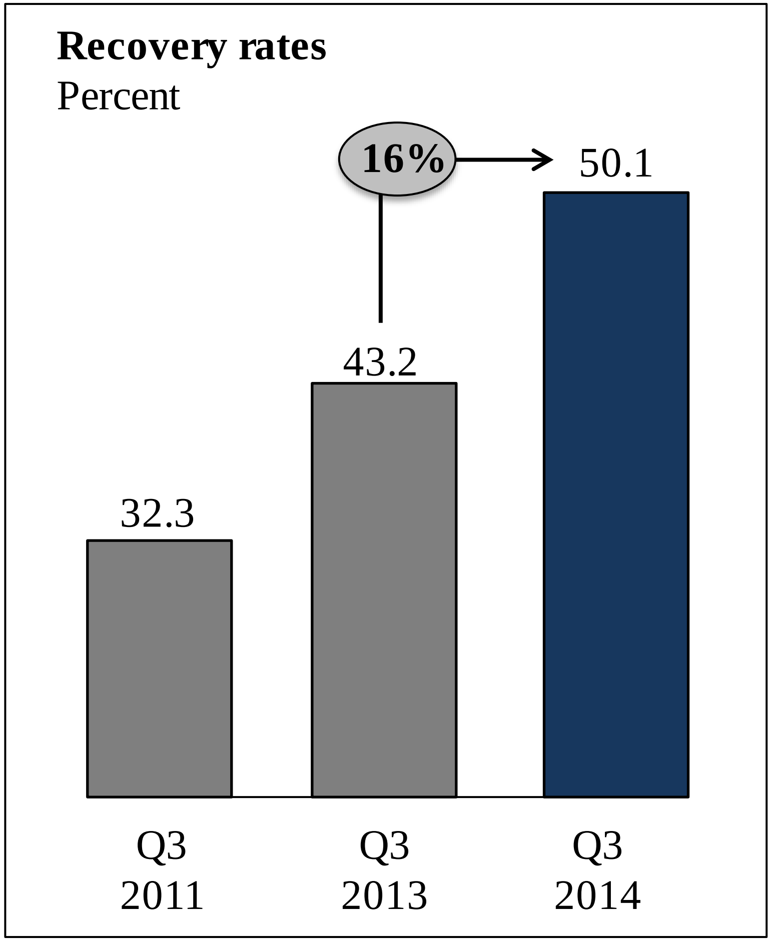


1. FY 2014 actual is $134 billion vs. Actuary's forecast of $191 billion

Source: FY2014 Actuarial Report, FY2014 FHA Annual Report

Lower delinquency rates and higher recovery rates leading to lower losses





Source: FHA

In addition to lower losses, adjustments to premiums have helped improve trajectory of Fund

Fiscal Years	Premium revenue as share of endorsements	Credit losses as share of endorsements	Net lifetime economic value[1]
1992-2000	3.1%	-2.2%	$8 Billion
2001-2006	2.6%	-4.1%	-$13 Billion
2007-2009	3.3%	-7.3%	-$27 Billion
2010-2013	5.6%	-2.8%	$34 Billion
2014	9.9%	-2.7%	$11 Billion

1. Based on historical to-date performance and independent actuarial projections of future performance. Net Economic Value is an assessment today of the lifetime value of each cohort to the Fund.

Source: FY 2013 and FY 2014 Independent Actuarial Review of the FHA Mutual Mortgage Insurance Fund and U.S. Department of HUD/FHA

Policy actions have driven improvements

Example actions

- ☐ Continued to avoid ‘toxic’ products (e.g. option arms, interest only, “no-doc” loans)
- ☐ Eliminated seller-assisted down-payment assistance
- ☐ Introduced a credit score floor
- ☐ Required at least 10% down-payment for credit score below 580
- ☐ Imposed higher minimum net-worth requirements for lenders
- ☐ Updated appraisal standards
- ☐ Introduced revised loss mitigation waterfall
- ☐ Expanded pre-foreclosure sale program
- ☐ Revamped note sale program and introduced DASP

1. DASP = Distressed Asset Stabilization Program

Source: HUD, FHA Monthly Reports

For example, DASP has saved the Fund billions and helped keep borrowers in their homes

Comparison of REO vs. DASP[1] process

Delinquency

Servicer loss mitigation

Foreclosure

REO disposition

Delinquency

Servicer loss mitigation

DASP auction

- DASP is an alternative to FHA's costly REO process[2]
- DASP also provides many borrowers a second chance

- DASP recoveries are **22% better than REO outcomes**
- Independent assessment concludes DASP will contribute **$1.4 billion in savings to the Fund**
- Thus far, nearly 10,000 or 18% of borrowers who went through DASP avoided an already initiated foreclosure
- Another 54% have been given extended timelines as their new servicers work through options

1. DASP = Distressed Asset Stabilization Program
2. REO sales expense and holding costs average $10,000 to $12,000 per vacant property (~$1 billion to ~$2 billion per year)

Source: HUD, FHA Monthly Reports

Across a number of measures, the SF Forward portfolio has seen significant improvements[1]

~$40 Billion in available cash reserves

~$10 Billion of additional economic value added each year

30% Drop in seriously delinquent rates

68% Improvement in recovery rates

63% Reduction in foreclosure starts

85% Drop in early payment defaults

1. Improvement rates are relative to peak or trough

Source: HUD

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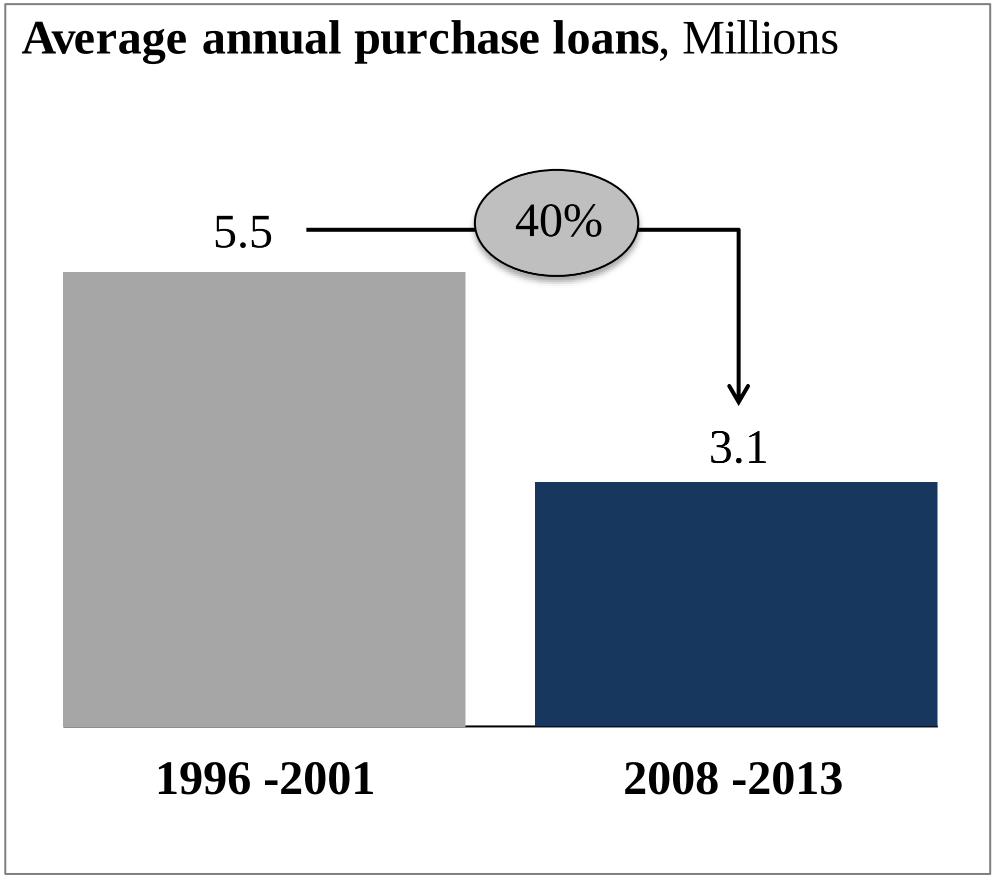
Source: FY2014 Actuarial Report, FY2014 FHA Annual Report

Clear problem with constrained access for qualified households



- According to Urban Institute up to 1.2 million potential borrowers (annually) are not participating in the market
- Large share of American households either turned down for credit or don't believe they can get credit[1]
  - ~29% of respondents turned down for credit
  - ~19% put off applying because they believed they would be turned down
- Many reasons for challenged market:
  - Lender overlays (e.g., FICO 'floors' to minimize re-purchase risk)
  - Industry focus on replenishing reserves and building capital
  - Affordability challenge

1. 1,359 Households respond to question: "Please tell us if each of these happened in the last 12 months…"

Source: Urban Institute, HMDA, MBA, CoreLogic, Federal Reserve of New York Report on the Economic Well-Being of U.S. Households

Near term priorities

- **Continued focus on our Blueprint For Access**
  - Formally launch FHA Homeowners Armed with Knowledge (HAWK)
  - Implement changes to Quality Assurance process
- **Continued focus on policies that improve the Fund**
  - Contain risk in HECM program
  - Further improve recoveries in Forward portfolio
  - Refine loss mitigation in Forward portfolio

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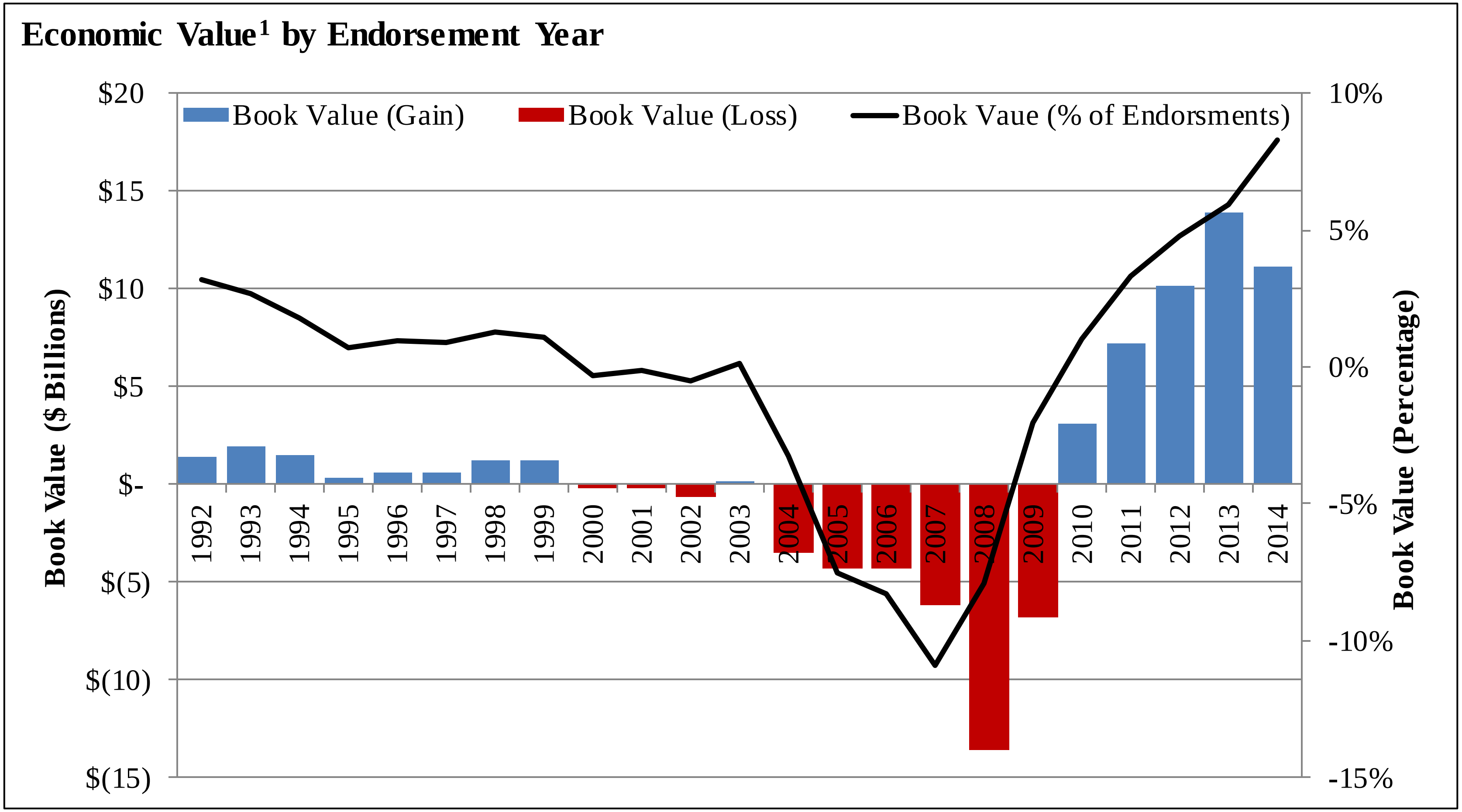
Appendix

Improvements are evident in FHA’s recent books

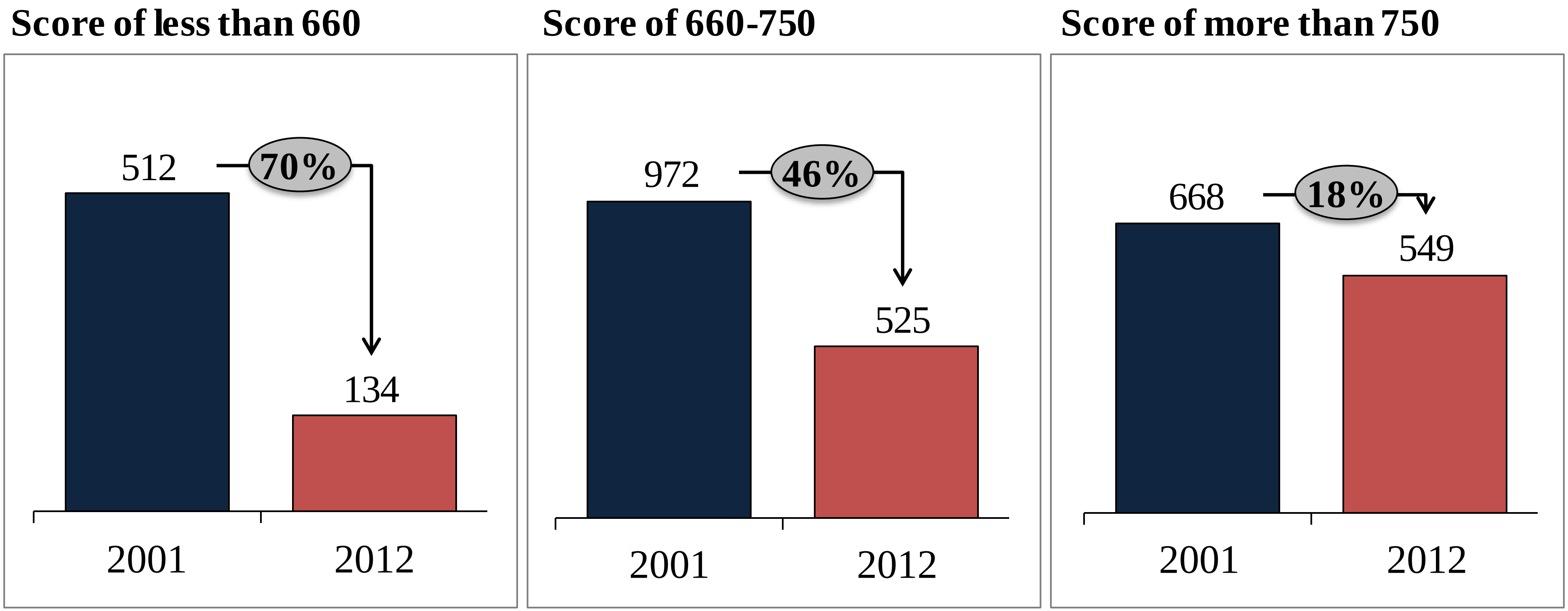


1. Economic Value (or Book Value) is defined as total premiums to be collected minus total expected losses (e.g., in FY2014, FHA collected $11 billion in excess premiums above what is required to cover expected losses)

Source: FY2014 Actuarial Report, FY2014 FHA Annual Report

Many borrowers are having a hard time making it back into the market

Change in purchase activity by credit score, in thousands[1]



1. Only includes data from HMDA

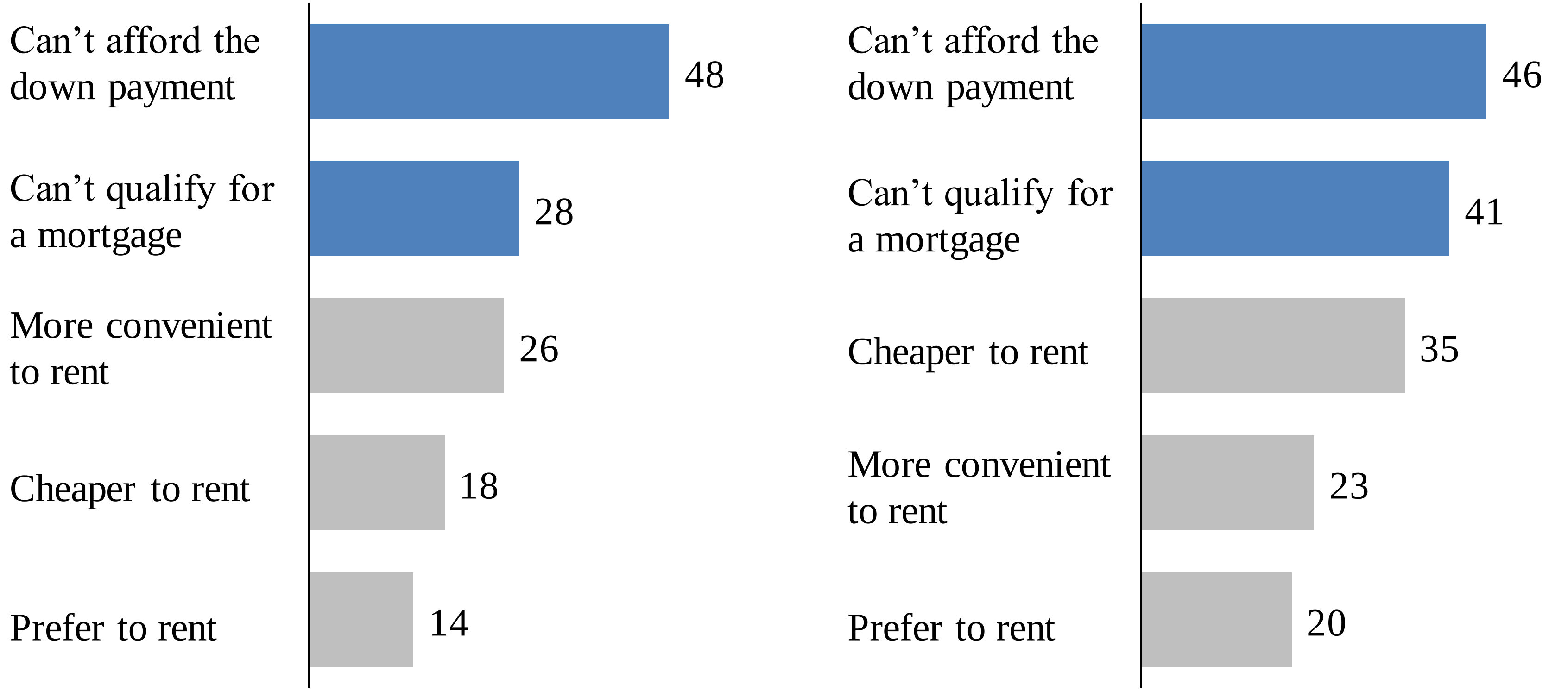
Source: Urban Institute

Affordability and credit are the primary barriers for those interested in buying a home

Reason(s) for renting rather than owning your home? (by age)

30-44 year age group, Percent of respondents

45-59 year age group, Percent or respondents



Source: Federal Reserve of New York Report on the Economic Well-Being of U.S. Households